# *STATE OF MONTANA*

## Public Employees' Retirement Board

***A Component Unit of the State of Montana***

## Comprehensive Annual Financial Report

**For the Fiscal Year Ended**
**June 30, 2002**

**Public Employees' Retirement System - Defined Benefit Retirement Plan**

**Municipal Police Officers' Retirement System**

**Game Wardens' and Peace Officers' Retirement System**

**Sheriffs' Retirement System**

**Judges' Retirement System**

**Highway Patrol Officers' Retirement System**

**Firefighters' Unified Retirement System**

**Volunteer Firefighters' Compensation Act**

**Public Employees' Retirement System - Defined Contribution Retirement Plan**

**Deferred Compensation (457) Plan**

**Prepared By:**
**The Fiscal Services Bureau**
**Public Employee Retirement Administration**
**100 North Park, Suite 100 ~ P O Box 200131**
**Helena, MT 59620-0131**
**(406) 444-3154**

# Table of Contents

The Montana Public Employee Retirement Administration will efficiently provide quality benefits, education and service to help our plan members and beneficiaries achieve a quality retirement.

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## Montana Public Employees' Retirement Board

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2001

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

Government Finance Officers Association of the United States and Canada Corporation Seal Chicago

President

Executive Director

The Montana Public Employee Retirement Administration will efficiently provide quality benefits, education and service to help our plan members and beneficiaries achieve a quality retirement. The Montana Public Employee Retirement Administration will efficiently provide quality benefits, education and service to help our plan members and beneficiaries achieve a quality retirement. The Montana Public Employee Retirement Administration will efficiently provide quality benefits, education and service to help our plan members and beneficiaries achieve a quality retirement.

**PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION**

JUDY MARTZ
GOVERNOR

STATE OF MONTANA

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HELENA, MONTANA 59620-0131

November 29, 2002

The Honorable Judy Martz
Governor of Montana
Room 204, State Capitol
PO Box 200801
Helena, MT 59620

Dear Governor Martz:

The Public Employees' Retirement Board (PERB) and its staff, the Montana Public Employee Retirement Administration (MPERA), are pleased to submit this *Comprehensive Annual Financial Report* (CAFR) for the fiscal year ended June 30, 2002, in accordance with 19-2-407, Montana Code Annotated. The PERB is a discretely presented component unit Pension Trust Fund of the State of Montana financial reporting entity. For this reason, the financial statements contained in this report are also included in the State of Montana Comprehensive Annual Financial Report.

The Public Employees' Retirement Board administers ten separate retirement plans, each reported in this CAFR. They include the ***Public Employees' Retirement System-Defined Benefit*** *Retirement Plan* (in its 58th year of operation) and ***Public Employees' Retirement System-Defined Contribution*** *Retirement Plan* (implemented in July 2002), ***Municipal Police Officers' Retirement System, Game Wardens' and Peace Officers' Retirement System, Sheriffs' Retirement System, Judges' Retirement System, Highway Patrol Officers' Retirement System, Firefighters' Unified Retirement System, Volunteer Firefighters' Compensation Act*** and the ***Deferred Compensation (457) Plan.***

The CAFR is divided into five sections:

- an *Introductory Section,* which contains the table of contents, letter of transmittal and administrative organization;
- a *Financial Section,* which contains the report of the Independent Auditors, the Management Discussion and Analysis, the financial statements of the PERB, certain required supplementary information and supporting schedules of administrative expenses, investment expenses and payments to consultants;
- an *Investment Section,* which contains a report on investment activity, investment policies, investment results and various investment schedules;
- an *Actuarial Section,* which contains the Actuary's Certification Letter and the results of the biennial actuarial valuation; and,
- a *Statistical Section,* which includes significant data pertaining to the plans.

Fiduciary responsibility for the systems rests with the PERB, which consists of seven members, appointed by the Governor. The members are assigned five-year, staggered terms. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation rests with the MPERA. This CAFR was prepared in conformance with the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board. Defined benefit, and defined contribution transactions are reported on the accrual basis of accounting. Sufficient internal accounting controls exist to provide reasonable assurance regarding the fair presentation of the financial statements, supporting schedules and the safekeeping of assets.

The pages that follow report the facts and figures that are the result of hard work, new initiatives, improved processes and continuing efforts we have made to meet the needs of our customers. We trust that you and the members of the plans will find this CAFR helpful in understanding the retirement plans.

### ADDITIONS TO PLAN NET ASSETS

The pension trust collections of employer, employee and state contributions, as well as income from investments, provide the reserves needed to finance retirement benefits. Below is a table presenting a comparison of the fiscal year 2002 and 2001 financial data for the defined benefit plans.

***Defined Benefit Plans Additions to Plan Net Assets***

| | FY2002 | FY2001 | Inc/(Dec) Amount | Inc/(Dec) Percentage |
|---|---|---|---|---|
| Member Contributions | $ 69,126,435 | $ 65,247,561 | $ 3,878,874 | 6 % |
| Employer Contributions | 69,228,566 | 65,774,583 | 3,453,983 | 5 % |
| State Contributions | 13,800,938 | 12,902,049 | 898,889 | 7 % |
| Education Contributions | 812,277 | 768,130 | 44,147 | 6 % |
| Registration Fees | 308,973 | 335,107 | (26,134) | (8) % |
| Retirement Incentive Contr. | 188,962 | 228,442 | (39,480) | (17) % |
| Interest Reserve Buyback | 163,778 | 68,304 | 95,474 | 140 % |
| Membership Fees | 167 | 393 | (226) | (58) % |
| Miscellaneous Revenues | 596 | 2,192 | (1,596) | (73) % |
| Operating Income | - | 25,500 | (25,500) | (100) % |
| Investment Income | (240,373,885) | (174,908,876) | (65,465,009) | (37) % |
| **Totals** | **$ (86,743,193)** | **$ (29,556,615)** | **$ (57,186,578)** | **(193) %** |

Contributions and investment income for the defined benefit pension trust funds for fiscal year 2002 totaled $(86,743,193) due primarily to the decline in investment income in fiscal year 2002. The defined benefit plans are managed on a long-range basis that allows for recovery of years when the market trends decrease. By looking at the rates of return for a 5-year period, it is found that the return for every plan is still recording better than a 4% return. This information is available in the *Investment Section* of this annual report.

License Fees have been categorized as employer contributions in fiscal year 2002 and retroactively as such in fiscal year 2001. Interest reserve buybacks have increased because there have been more mandatory retroactive payments with interest in fiscal year 2002. Retirement incentive contributions have decreased due to a fewer number of employees taking advantage of the Employee Protection Act. Miscellaneous revenues decreased because there was not a need for employees to volunteer as in the 2001 fire season. Operating Income was zero this year because the building at 1712 Ninth Avenue in Helena was transferred to the Board of Investments in fiscal year 2001. Investment income decreased because of the continuing downward trend in the market in fiscal year 2002.

Below is a table presenting a comparison of the fiscal year 2002 and 2001 financial data for the defined contribution plans.

***Defined Contribution Plans Additions to Plan Net Assets***

| | FY2002 | FY2001 | Inc/(Dec) Amount | Inc/(Dec) Percentage |
|---|---|---|---|---|
| Member Contributions | $ 13,313,925 | $ 12,010,172 | $ 1,303,753 | 11 % |
| Employer Contributions | 46,412 | 21,351 | 25,061 | 117 % |
| Miscellaneous Revenues | 222,793 | 232,487 | (9,694) | (4) % |
| Investment Income | (4,430,904) | (2,957,687) | (1,473,217) | (50) % |
| **Totals** | **$ 9,152,226** | **$ 9,306,323** | **$ (154,097)** | **(2) %** |

The defined contribution plans include the PERS-DCRP and the Deferred Compensation Plan. Contributions into the PERS-DCRP will not begin until fiscal year 2003. In fiscal year 2002, the contributions and investment income totaled $9,152,226. Member contributions increased because participants decided to join and/or decided to make additional contributions and because of the changes in the federal laws. Employer contributions increased because the one employer that contributes on the employees' behalf joined the deferred compensation plan in January 2001. This means the employer made contributions for 6 months of fiscal year 2001 and for 12 months in fiscal year 2002. Investment income decreased because of the continuing downward trend in the market in fiscal year 2002.

### DEDUCTIONS TO PLAN NET ASSETS

The principle purpose for which the pension trust plans were created was to provide retirement, survivor and disability benefits to qualified members and their beneficiaries. The cost of such programs include recurring benefit payments as designated by the plan, refund of contributions to terminated employees, and the cost of administering the plans. On the following page is a table presenting a comparison of the defined benefit fiscal year 2002 and 2001 financial data.

### *Defined Benefit Plans Deductions to Plan Net Assets*

| | FY2002 | FY2001 | Inc/(Dec) Amount | Inc/(Dec) Percentage |
|---|---|---|---|---|
| Benefit Payments | $ 145,783,245 | $ 130,154,139 | $ 15,629,106 | 12 % |
| Member Refunds | 11,964,539 | 12,973,827 | (1,009,288) | (8) % |
| Refunds to Other Plans | 438,608 | 243,710 | 194,898 | 80 % |
| Supplemental Insurance | 12,675 | 11,775 | 900 | 8 % |
| Administrative Expenses | 3,531,088 | 2,514,021 | 1,017,067 | 40 % |
| Other Expenses | - | 6,643 | (6,643) | (100) % |
| **Totals** | **$ 161,730,155** | **$ 145,904,115** | **$ 15,826,040** | **11 %** |

For the defined benefit plans, expenses for fiscal year 2002 totaled $161,730,155, an increase of 11 percent over fiscal year 2001 expenses. The increase in benefit payments is due to additional retired members and benefit enhancements given by the 2001 Legislature. The refunds to other plans increased due to federal law changes permitting greater mobility between retirement plans. The increase in administrative expenses is related to the education campaign, increase in staff, systems support and communication efforts. The PERB contracted with outside consultants to assist with the education of PERS-DBRP members concerning their choice beginning July 1, 2002. The MPERA is also taking advantage of technological advances supporting our goal to provide the best service possible to members. In fiscal year 2002, expenses of $161,730,155 exceeded revenues of $(86,743,193) by $248,473,348.

Below is a table presenting a comparison of the fiscal year 2002 and 2001 financial data for the defined contribution plans.

### *Defined Contribution Plans Deductions to Plan Net Assets*

| | FY2002 | FY2001 | Inc/(Dec) Amount | Inc/(Dec) Percentage |
|---|---|---|---|---|
| Benefit Payments | $ 11,459,674 | $ 7,101,578 | $ 4,358,096 | 61 % |
| Administrative Expenses | 687,309 | 445,469 | 241,840 | 54 % |
| Miscellaneous Expenses | 810,882 | 829,418 | (18,536) | (2) % |
| **Totals** | **$ 12,957,865** | **$ 8,376,465** | **$ 4,581,400** | **55 %** |

For the defined contribution plans, total expenses for fiscal year 2002 totaled $12,957,865, an increase of 55 percent over fiscal year 2001 expenses. The increase in benefit payments is attributable to the Deferred Compensation Plan since the PERS-DCRP had no members in fiscal year 2002. Most of the increase in administrative costs are associated with the implementation of the PERS-DCRP. To implement the plan, it was necessary to staff the required positions and contract with outside vendors to ensure that the plan qualifies under federal regulations. Miscellaneous expenses include charges from Allianz, Aegon and Great West Life & Annuity Insurance Co. The decrease in miscellaneous expenses are primarily due to the reduction in charges by Aegon and Great West because of the reduced charges included in the new contract. In fiscal year 2002, expenses of $12,957,865 exceeded revenues of $9,152,226 by $3,805,639.

## INVESTMENTS

The investments of the plans are governed, primarily, by an investment standard known as the "prudent expert principle." The prudent expert principle is constitutionally and statutorily mandated and establishes a standard for all fiduciaries, which includes anyone that has authority with respect to the fund. The prudent expert principle states that fiduciaries will discharge their duties solely in the interest of the fund participants and beneficiaries and with the degree of diligence, care and skill which prudent experts would ordinarily exercise under similar circumstances in a like position. By following the prudent expert principle and permitting further diversification of investments within a fund, the fund may be enabled to reduce overall risk and increase returns. A summary of the asset allocation can be found in the *Investment Section* of this annual report.

The prudent expert principle permits the PERB to establish an investment policy based upon certain investment criteria and allows for the delegation of investment authority to the BOI, Department of Commerce. The statement of investment policy outlines the responsibility for the investment of the funds and the degree of risk that is deemed appropriate for the funds. Investment officers are to execute the investment policy in accordance with statutory authority, the PERB's policy and their respective guidelines, but are to use full discretion within the policy and guidelines. For fiscal year 2002, the Public Employees' Retirement System's (PERS') total rate of return on investments was (7.23) percent. The PERS' rate of return over the last three years has averaged (1.66) percent per year, over the last five years the rate of return has averaged 4.46 percent.

## FUNDING

Pension funds are well-funded when there is enough money in reserve to meet all expected future obligations to participants. The PERB's funding objective is to meet long-term benefit promises through contributions that remain approximately level as a percent of member payroll. The greater the level of funding, the larger the ratio of assets accumulated to the actuarial accrued liability and the greater the level of investment potential. The advantage of a well-funded plan is that the participants can look at assets that are committed to the payment of benefits. A detailed discussion of funding is provided in the *Actuarial Section* of this annual report beginning on page 99.

## ECONOMIC CONDITION AND OUTLOOK

The economic outlook of the plans is based primarily upon investment earnings. For 2002, the PERS experienced a (7.23) percent fair value rate of return, for the last three years an average annualized rate of return of (1.66) percent and for the last five years an average annualized rate of return of 4.46 percent. The plans are required to be maintained on an actuarially sound basis as certified in this report by our actuary, thus protecting participants' future benefits. For the GWPORS, based on current actuarial assumptions the current normal cost is more than the statutory contribution rate. Due to the membership increase, the accurate normal cost will need to be determined. At this time the bear market has affected earnings, but we anticipate that over the long-term our earning rates will continue to meet our actuarial assumed earning rates. Based on the report of our actuary, two of the eight defined benefit plans had surplus funding as of June 30, 2002.

The PERS-defined contribution retirement plan was implemented July 1, 2002. Each eligible PERS member may choose membership in either the defined benefit retirement plan (DBRP) or the defined contribution retirement plan (DCRP). University employees may also have the option of joining the Optional Retirement Program (ORP) administered by Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF New York, NY).

The DCRP option requires the education coordinator to inform members and employers of the PERS about the options and benefits of the DCRP and the DBRP. Education has been funded by one-tenth of one percent of employer contributions from the PERS-DBRP. Beginning July 1, 2002, the funding is reduced to 0.04% of employer contributions.

The MPERA has implemented a web reporting system. The advantage of using advanced technologies results in more accurate reporting and more timely deposits to participants' accounts.

**PROFESSIONAL SERVICES**

The PERB contracts with consultants for professional services that are essential to the effective and efficient operation of the systems. An opinion from the Independent Auditors and the actuary are included in this report. The FY2002 valuation was performed by the PERB's actuary, Milliman U.S.A.

Some outside consultants contracted by the PERB are: Educational Technologies, Inc., BearingPoint (formerly KPMG Consulting), Computer Consulting Corporation, Arnerich Massena & Assoc., Inc., William M. Mercer, Inc., Milliman U.S.A., Ice Miller, Communications & Management Service, Lawrence R. McEvoy, M.D., and Comsev, Inc. Others include the Legislative Audit Division, the Legal Services Division and the Professional Development Center. A schedule of consultants appears on page 76.

**CERTIFICATE OF ACHIEVEMENT**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Montana Public Employees' Retirement Board for its comprehensive annual financial report for the fiscal year ended June 30, 2001. This was the fourth consecutive year that the Montana Public Employees' Retirement Board has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

**ACKNOWLEDGEMENTS**

The compilation of this report reflects the efforts of the staff of the Montana Public Employee Retirement Administration. This report is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship of the funds of the plans.

The reporting employers of each retirement system form the link between the plans and the members. Their cooperation contributes significantly to the success of the plans. We hope the employers and their employees find this report informative.

On behalf of the PERB, we would like to take this opportunity to express our gratitude to the staff, the advisors and the many people who have worked so diligently to assure the successful operation of the plans.

Respectfully submitted,

*Signature on File*

Michael O'Connor, Executive Director
Montana Public Employee Retirement Administration

*Signature on File*

Terry Teichrow, President
Public Employees' Retirement Board

# Public Employees' Retirement Board

*A Component Unit of the State of Montana*

**Terry Teichrow,** President
Helena
Active Member
Education Specialist
Office of Public Instruction
Term exp. 3/31/2005

**Carole Carey,** Vice Pres.
Ekalaka
Active Member
Clerk of District Court
Carter County
Term exp. 3/31/2007

**Robert Griffith**
Helena
Private Citizen
Term exp. 3/31/2003

**N. Jay Klawon**
Hamilton
Investment Management Experience
Investment Representative, Edward Jones
Term exp. 3/31/2004

**Carol Lambert**
Hammond
Private Citizen
Rancher
Term exp. 3/31/2006

**Troy McGee**
Helena
Retired Public Employee
Term exp. 3/31/2003

**Jean Thompson**
Billings
Active Member
Clerk of District Court
Yellowstone County
Term exp. 3/31/2004

The Public Employees' Retirement Board as pictured from left to right are: (sitting) Carole Carey, Carol Lambert and Jean Thompson; (standing) Jay Klawon, Robert Griffith, Troy McGee and Terry Teichrow

## Mission Statement of the MPERA

The Montana Public Employee Retirement Administration will efficiently provide quality benefits, education and service to help our plan members and beneficiaries achieve a quality retirement.

# Public Employee Retirement Board

*A Component Unit of the State of Montana*

## MPERA Organizational Chart